

**PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA**

ENERGY DIVISION

Item #24 (Rev. 1)  
AGENDA ID 14151  
RESOLUTION G-3504  
August 13, 2015

**R E S O L U T I O N**

**Resolution G-3504.** Southern California Gas Company's Annual Compliance Report for gas procurement activities to maintain Southern System reliability under Gas Rule 41.

**PROPOSED OUTCOME:**

- This Resolution approves most of the costs of the procurement activities undertaken to maintain Southern System reliability during the period from September 1, 2013, through August 31, 2014, with modifications. The Commission requires more information in order to find five of the transactions reasonable under Rule 41. In addition, a required section on overnomination events was not included. A supplemental Advice Letter is required.

**SAFETY CONSIDERATIONS:**

- This resolution evaluates activities to maintain system reliability. These activities have an indirect impact on safety since they are taken to avoid curtailments to customers, some of whom may provide essential services.

**ESTIMATED COST:**

- Net cost of \$12.9 million.

By Advice Letter 4690 filed on September 19, 2014.

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**SUMMARY**

Southern California Gas Company (SoCalGas) submitted Advice Letter (AL) 4690 on September 19, 2014, in compliance with Decision (D.) 09-11-006 and Gas Rule 41, providing an Annual Compliance Report (ACR) for the period September 1, 2013, through August 31, 2014. SoCalGas included 176 transactions

attributable to the purchase and sale of gas and related backbone transportation service (BTS) charges made by SoCalGas to maintain Southern System minimum flow requirements. **This resolution approves all of the sales transactions. All but five of the purchase transactions are also approved.**

Different sections of Rule 41 state the criteria or conditions under which SoCalGas southern system purchases and sales may be found to be reasonable. In 2013-14, there were 176 purchase transactions. Of these, 161, or 91%, of all purchases met the requirements of either Section 13 or Section 14 of Rule 41. Of the remaining 15 purchases, four met the requirements of Section 15, and six met the requirements of Section 18 of Rule 41. Despite making up only 3% of transactions, Section 18 purchases accounted for 82% of the volume and 78% of the dollar value of all purchase transactions.

**Five of the transactions submitted under Sections 13 and 14 did not meet the requirements for reasonableness under those Sections.** SoCalGas must submit additional information to demonstrate the reasonableness of those transactions.

**SoCalGas did not submit a required section discussing overnomination events. SoCalGas must submit a supplemental advice letter to justify the reasonableness of the five transactions and to provide the required information on overnomination events.**

**Future ACRs should provide additional information as discussed later in this resolution.**

## **BACKGROUND**

The southern part of the SoCalGas gas transmission pipeline system (the Southern System) requires a minimum amount of flowing supplies to operate effectively, which varies depending on conditions. When deliveries into the Southern System are too low, it is difficult to operate efficiently and safely and to assure deliveries to customers.

The SoCalGas Gas Acquisition Department had previously maintained minimum flowing supplies using core customer assets. D.07-12-019 approved the transfer of responsibility for managing minimum flow requirements from the SoCalGas Gas Acquisition Department to the Utility System Operator (System

Operator). As required by D.07-12-019, the System Operator took over the responsibility for managing these minimum flows as of April 1, 2009.<sup>1</sup>

D.07-12-019 also approved the following tools, which can be used by the System Operator to meet Southern System reliability requirements:

- the ability to buy and sell gas on a spot basis as needed;
- the authority and the requirement to conduct at least one annual request for offers (RFO) seeking proposals for managing minimum flows; and
- the authority to submit an Advice Letter for approval of contracts that result from an RFO or open season process.

**Subsequent resolutions adopted by the Commission authorized additional tools.**

Resolution G-3474 for SoCalGas AL 4353, issued on July 17, 2012, approved an additional tool allowing the System Operator to move natural gas from Blythe, California, to Otay Mesa, California, in order to support minimum flow requirements on the Southern System.<sup>2</sup>

Resolution G-3487 for AL 4516, issued on October 7, 2013, gave the System Operator the authority to enter into baseload gas contracts in order to improve Southern System reliability provided they meet certain criteria.<sup>3</sup>

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<sup>1</sup> As stated in Rule 41, the mission of the Utility System Operator is to maintain system reliability and integrity while minimizing costs at all times. The System Operator includes all of the departments within SoCalGas and San Diego Gas & Electric Company that are responsible for the physical and commercial operation of the pipeline and storage systems and specifically excludes the Utility Gas Procurement Department.

<sup>2</sup> Operation of this tool is presented in Section 15 of Rule 41. Decision 07-12-019 notes that supplies delivered at Otay Mesa may assist in fulfilling the minimum flowing gas supply requirement at Blythe. The SoCalGas System Operator has successfully used deliveries at Otay Mesa to support Southern System requirements, and Resolution G-3474 approved deliveries of supplies to Otay Mesa from Blythe as a System Operator tool. Otay Mesa is located at the California-Mexico border, approximately 10 miles inland from the Pacific Ocean. Blythe is located at the California-Arizona border, approximately 120 miles east of Palm Springs.

<sup>3</sup> Section 18 of Rule 41 includes the following criteria for establishing the reasonableness of baseload contracts: 1) the total cumulative baseload volume cannot exceed 255,000 Dths/day; 2) the price must be less than or equal to NGI's Bidweek average for "Southern Cal. Bdr. Avg."

*Footnote continued on next page*

**Pursuant to D.09-11-006, SoCalGas must submit an Annual Compliance Report to demonstrate that the natural gas procurement activities it undertook to support Southern System reliability were in compliance with the standards, criteria, and procedures described in Sections 9 through 18 of Rule 41. The Annual Compliance Report must be submitted by a Tier 3 Advice Letter.**

Resolution G-3486 for AL 4515, issued on December 5, 2013, approved a revision to SoCalGas' Rule No. 30 (Rule 30) that clarified the procedures to be used when there is a system-wide overnomination but additional supplies are still needed in the Southern System.<sup>4</sup> The resolution also required SoCalGas to include the following information in its Annual Compliance Report: 1) the frequency of events where overnominations occurred system-wide yet the System Operator was required to maintain minimum flows, 2) the effectiveness of the 10% margin of error and any need to increase or decrease the margin, and 3) the observed impact on other receipt points.

In AL 4690, filed on September 14, 2014, SoCalGas asserts that its gas procurement activities to maintain Southern System reliability during the 12 months from September 1, 2013, through August 31, 2014, were in compliance with Rule 41. During this period, SoCalGas reports gas purchase costs of \$185,142,449<sup>5</sup> to meet Southern System minimum flow requirements. The gas was then resold at the SoCal Citygate for \$177,131,296, yielding a net cost of \$8,011,153. An additional \$4,921,378 in backbone transportation service charges was incurred.<sup>6</sup> The total net cost, consisting of \$8,011,153 for the net cost of purchases after resale and \$4,921,378 for transportation, was \$12,932,531.<sup>7</sup>

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plus 8.2 cents/Dth; 3) the term is limited to the December-March season; and the baseload contracts can only be made during the nine-month period directly preceding that season.

<sup>4</sup> Resolution G-3486 added the following language to Rule 30: "Southern Transmission Receipt Points will not be reduced in any cycle below 110% of the Southern System minimum flowing supply requirement established by the Gas Control Department."

<sup>5</sup> Total purchase costs have increased from \$8.2 million in 2010-11 to \$185.1 million in 2013-14.

<sup>6</sup> This equates to an average BTS charge of 13.3 cents/dth for the period covered by the ACR compared to 6.4 cents/dth for the previous 12-month period. The comparable BTS tariff rate was up to 15.406 cents/dth in 2014 and 13.764 cents/dth in 2013.

<sup>7</sup> The total net cost of \$12.93 million was 64% higher than the \$7.88 million spent by SoCalGas to provide system reliability services during the previous 12-month period. However, the volume purchased was 91% higher (36,946,128 dths in 2013-14 vs. 19,319,690 dths in 2012-13). The net

*Footnote continued on next page*

SoCalGas states that 65% of all purchase transactions and all but three sales transaction were within the automatic safe harbor price limits described in Section 13 of Rule 41. SoCalGas asserts that the remainder met the requirements of Sections 14, 15, or 18 and that it has met the criteria and followed the necessary processes for reasonable spot gas purchases and sales detailed in Rule 41.

SoCalGas did not include the information about overnomination events required in Resolution G-3486 in its Annual Compliance Report.

### **NOTICE**

Notice of AL 4690 was made by publication in the Commission's Daily Calendar. SoCalGas states that a copy of the Advice Letter was sent to SoCalGas' GO 96-B service list and the Commission's service list in Application (A.) 11-11-002, the 2013 SoCalGas/SDG&E TCAP.

### **PROTESTS**

Advice Letter 4690 was not protested.

### **DISCUSSION**

**This resolution approves all of the sales transactions presented in AL 4690. All but five of the purchase transactions are also approved.**

SoCalGas incurred procurement costs of \$185,142,449 for spot and baseload purchases as well as \$4,921,378 in backbone transportation services charges. Sales of the purchased gas yielded \$177,131,296. After these sales, the total net cost, including transportation, was \$12,932,531.

Rule 41 specifies the criteria for determining if the net cost of spot and baseload gas purchases/sales was incurred reasonably. These criteria are spelled out in Sections 13, 14, 15, 16, and 18 of the rule.

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cost per dth purchased was 14% lower: 35 cents/dth compared to 41 cents/dth the previous year.

**Section 13** states that purchases and sales must be within a specified range. For day-ahead transactions, the range is +/- 10% of the Intercontinental Exchange (ICE) Weighted Average Index. For intraday transactions, the purchase price can be no more than 110% of the ICE High, and the sales price can be no less than 90% of the Ice Low.

**Section 14** applies to purchases and sales that fall outside the Section 13 safe harbor range. For purchases, if volumes available on ICE meet or exceed the minimum flow requirements, transactions for the volumes offered through ICE are deemed reasonable. When less than the required volume is available on ICE, offers from at least three different suppliers must be obtained for comparison. SoCalGas must then accept the lowest cost offers that meet the quantities required.

Section 14 provides little guidance for sales, stating only that: "The Operational Hub may also post an offer/bid on ICE for volumes."

**Section 15** provides that when the Gas Control Department determines that deliveries at Otay Mesa are necessary to meet minimum flow requirements, such requirements may be satisfied either through spot purchases at Otay Mesa or through the movement of supplies from Blythe to Otay Mesa. The movement of supply will be deemed reasonable if (1) the cost of moving the gas is less than or equal to the difference between the ICE Weighted Average Index for Blythe and the cost of spot gas available for purchase at Otay Mesa for the relevant flow date, or (2) if sufficient spot supplies are not available for purchase at Otay Mesa for the relevant flow date, and the movement fills some or all of the shortfall between supplies needed at Otay Mesa and supplies available for purchase at Otay Mesa.

**Section 16** states that purchases and sales other than those described in Sections 14 and 15 will not be deemed unreasonable but shall be subject to review by the Commission's Energy Division.

**Section 18** allows SoCalGas to enter into baseload contracts for the months December-March in order to reduce the amount of gas it needs to purchase on the daily spot market.

As required by Resolution G-3480, AL 4690 provided the following table showing a breakdown of purchase transactions and associated dollar amounts by the Sections of Rule 41 with which SoCalGas asserts each transaction complies.

**Southern System Purchases, September 2013-August 2014**

	Number of Transactions	%	\$	%
Section 13	115	65%	\$22,989,851	12%
Section 14	51	29%	\$16,138,175	9%
Section 15	4	2%	\$718,650	0%
Section 18	6	3%	\$145,295,772	78%
Total	176	100%	\$185,142,448	100%

Energy Division staff reviewed Attachment F to AL 4690 and found that five transactions were incorrectly categorized in this table. The table below corrects those errors.

**Revised: Southern System Purchases, September 2013-August 2014**

	Number of Transactions	%	\$	%
Section 13	114	65%	\$22,866,150	12%
Section 14	47	27%	\$15,061,052	8%
Section 15	4	2%	\$718,650	0%
Section 16	5	3%	\$1,200,824	1%
Section 18	6	3%	\$145,295,772	78%
Total	176	100%	\$185,142,448	100%

**The Energy Division's review of information provided with Advice Letter 4690 and received through data request responses confirms that the 114 purchases shown as meeting Section 13 criteria and the 47 purchases shown as meeting Section 14 criteria in the revised table are accurately characterized and therefore deemed reasonable.**

**Four transactions were incorrectly categorized by SoCalGas as Section 14 rather than Section 16 purchases:**

- TC# 2157 for flow date 9/5/13, for a purchase cost of \$824,715;
- TC# 2351 for flow date 11/27/13 for a purchase cost of \$46,515;
- TC#2443 for flow date 2/4/14 for a purchase cost of \$34,750; and
- TC#2444 for flow date 2/4/14 for a purchase cost of \$171,143.

**In all four cases, SoCalGas did not solicit three additional bids after Section 13 offers were exhausted as is required by Section 14.**

Section 14 states:

Purchases or sales at prices that are outside the ranges specified in Section 13 (a) and (b) above shall nevertheless be deemed reasonable if the Operational Hub abides by the following procedure: When the Gas Control Department determines that spot purchases are necessary to meet minimum flow requirements, the Operational Hub shall monitor ICE and record the relevant price information, if available, for deliveries of gas at all relevant trading points. If volumes available on ICE meet or exceed the minimum flow requirements, transactions for the volumes offered through ICE shall be deemed reasonable. The Operational Hub may also post an offer/bid on ICE for volumes. When less than the required volumes are available on ICE, the Operational Hub shall contact gas suppliers (other than the Utility Gas Procurement Department or affiliates), request offers for the necessary supplies, and record their offers for gas delivered to the relevant trading points to ensure at least three offers from three different suppliers are available for comparison. The Operational Hub shall compare prices posted on ICE and, if applicable, prices quoted by its supplier contacts, and select the best prices available to meet the quantities required to meet minimum flow requirements. Verification that the Operational Hub has followed this procedure shall be provided to the CPUC in the Annual Compliance Report described in Section 25 below.

In response to an Energy Division data request about these transactions, SoCalGas made the following argument:

The relevant Section 14 safe harbor requires three offers from three different suppliers; it does not require two unaccepted offers, or for those offers to be outside Section 13 guidelines. All offers SoCalGas receives count towards meeting the Section 14 “three offers” safe harbor, and this has been the case for as long as we have been using Section 13 and Section 14. As a practical matter, it would not make sense for SoCalGas to seek transactions that satisfy Section 13, and then separately seek Section 14 transactions. Each of the referenced transactions satisfy Section 14 because SoCalGas received three offers from three different suppliers.

**The purpose of Section 14 is to ensure that the utility seeks multiple offers for comparison after the safe harbor price can no longer be obtained.**

At that time, three additional bids should be sought. When three additional bids cannot be obtained due to market conditions, then approval may be sought under Section 16. SoCalGas should incorporate this method into future transactions.

**One transaction was incorrectly categorized as a Section 13 rather than a Section 16 purchase.**

Transaction TC#2551 for flow date 8/12/14, was classified as being within the safe harbor. However, the cost (\$5.25/dth) is more than the Sec. 13(b) limit, which is 110% of the ICE High or \$4.7905. Since three additional bids were not solicited after Section 13 offers were exhausted, this transaction should have been categorized as a Section 16 purchase. The total purchase cost of this transaction was \$123,701.

It is not now possible to determine whether the five purchases could have been made at a lower price if SoCalGas had obtained additional bids. The Energy Division reviewed the transactions in question as if they had been conducted under Section 16.

Section 16 purchases are not deemed unreasonable but are subject to review by the Energy Division.

**The Energy Division has not received sufficient information from SoCalGas to determine whether the five transactions are reasonable. SoCalGas should provide additional information in a supplemental advice letter to explain why the five transactions should be found reasonable.**

**Furthermore, additional information for Section 13 transactions is required in future Annual Compliance Reports.**

In order for Energy Division to confirm that a transaction falls within the Section 13 safe harbor, staff need to know whether it was a day-ahead or an intraday purchase. In Attachment F, SoCalGas includes the date when the System Operator was notified that additional gas was needed and the flow date.

However, if a request is made after the close of Cycle 2 at 4:00 pm on the day preceding the flow date, then the gas must be purchased in Cycle 3, which is considered to be the intraday market. AL 4690 does not include information indicating the cycle in which the gas was purchased, although this information was provided in response to an Energy Division data request. Cycle data should be included in future ACRs.

**For sales, all but three transactions met the Section 13 safe harbor requirements and are deemed reasonable.**

This reporting period marks the first time that any sales have failed to meet the Section 13 criteria and thus the first time that Section 14 has been applied to sales transactions.

On February 5, 2014, when the purchase of 55,000 dths was initiated, a cold snap in the Midwest and East caused gas to be diverted away from California, driving day-ahead prices to record highs. On February 6, miscommunications between the California Independent System Operator and SoCalGas combined with the failure of the Diablo Canyon nuclear plant to return on-time from a planned outage caused a shortage of supply to noncore customers. However, at the SoCal Citygate prices fell significantly.

As a result, SoCalGas was unable to sell 20,000 dths at the safe harbor price. SoCalGas posted offers on ICE at prices above the posted bids for SoCal Citygate gas, but no buyers responded. Prices continued to trend downward, and SoCalGas accepted posted bids for the remaining gas. The selling price, \$8.05/dth, was below the applicable Section 13a price of \$10.75/dth.

**The explanation provided by SoCalGas is reasonable, and these three sales are approved under Section 14.**

It is worth noting that the extreme market volatility of the week of February 2- 8, 2014, caused a large number of purchases to be executed at an unusually high cost. Twenty-four of the year's 166 spot market purchases (14.5%) were made that week at prices that ranged from a low of \$5.70 to a high of \$33.00. The week's purchases totaled over \$12 million or 30.7% of all Section 13, 14, and 16 purchases. The net cost, including BTS charges, was \$6.27 million — nearly half the net cost of all spot and baseload transactions made in 2013-14 to support Southern System reliability.

**The four transactions representing the movement of supplies from Blythe to Otay Mesa were made consistent with Section 15 requirements and are deemed reasonable.** These four movements were in response to a request from Gas Operations for supplies at Otay Mesa. Prior to making these movements, SoCalGas verified that no supplies were available on ICE or through suppliers on the dates needed.

**After review, all but one of the baseload contract purchases and sales were found to be clearly in accordance with Section 18 criteria and are therefore deemed reasonable.**

On December 31, 2013, SoCalGas received 262,228 dths of gas under baseload contracts, which is above the 255,000 dth/day maximum specified in Section 18. In response to a data request, SoCalGas asserted that the extra 7,228 dths came from a supplier that had under-delivered earlier in the month. SoCalGas noted that the daily average volume for the month of December was less than 255,000 dth/day.

**The explanation provided by SoCalGas is reasonable, and this purchase is approved under Section 18.**

**In order for Energy Division to confirm that a transaction meets Section 18 criteria, staff need access to the NGI Bidweek averages on which price limits are based. While this information was provided in response to a data request, it should be included in all future ACRs.**

The 2013-14 reporting period was the first since Resolution G-3487 established Section 18, and the baseload contracts approved in that resolution represented a significant portion of total purchases. Despite making up only 3% of transactions, Section 18 purchases accounted for 82% of the volume and 78% of the dollar value of all purchase transactions.

Between December and February, SoCalGas purchased 255,000 dth/day in baseload supplies, and in March it bought 240,000 dth/day. The average purchase price was SoCalGas Border Average + 7.7 cents/dth. The gas was resold at the Citygate price after transporting the gas at an average BTS rate of 14.1 cents/dth. The net cost of these supplies (purchase price minus sales price plus BTS transport cost) was 13 cents/dth. SoCalGas provided the table below to show the cost-effectiveness of its baseload contracts for the Southern System.

**Cost-Effectiveness of Southern System Baseload Contracts**

	Volume: 12/13-3/14 (MMdth)	Net Cost (\$ Millions)	Net Average Cost (\$/Dth)
Baseload	30.4	\$3.9	\$0.13
Additional Spot Purchases Needed in Absence of Baseload	6.1	\$12.3	\$2.02
Difference	24.3	(\$8.4)	(\$1.89)

If the baseload contracts had not been in place, SoCalGas would have needed to purchase an additional 6.1 MMDth of spot gas on the days Gas Control called for more supplies. At an average net cost of \$2.02/dth, these spot gas purchases would have resulted in the utility incurring an additional net cost of \$8.4 million.

**The Annual Compliance Report did not include information on overnomination events as required by Resolution G-3486.**

This information should be provided in the supplemental advice letter.

**COMMENTS**

Public Utilities Code section 311(g) (1) provides that this resolution must be served on all parties and subject to at least 30 days public review and comment prior to a vote of the Commission. Section 311(g) (2) provides that this 30-day period may be reduced or waived upon the stipulation of all parties in the proceeding.

The 30-day comment period for the draft of this resolution was neither waived nor reduced. Accordingly, this draft resolution was mailed to parties on July 14, 2015. No comments were received.

**FINDINGS**

1. Pursuant to D.09-11-006 and Rule 41, SoCalGas must submit an Annual Compliance Report by October 1<sup>st</sup> to demonstrate that its natural gas procurement activities undertaken to support Southern System reliability were in compliance with certain standards, criteria, and procedures.

2. SoCalGas submitted AL 4690 on September 19, 2014 providing an Annual Compliance Report for the period September 1, 2013 through August 31, 2014.
3. SoCalGas incurred \$185,142,449 in procurement transaction costs to support Southern System reliability between September 1, 2013, and October 31, 2014. These costs were incurred through 176 spot and baseload purchases.
4. All but five of the gas purchases met the requirements to be deemed reasonable under Rule 41 and should be approved. Of the 176 purchases made, 114 met the criteria of Section 13 of Rule 41, 47 met Section 14 criteria, four met Section 15 criteria, and six met Section 18 criteria.
5. The Operational Hub made gas sales that resulted in a net cost, including transportation costs, of \$12,932,531.
6. All of the gas sales met the requirements to be deemed reasonable under Section 13, 14, or 18 of Rule 41 and should be approved.
7. Section 14 requires that three additional bids be sought after Section 13 offers are exhausted.
8. Five transactions were incorrectly categorized as falling under either Section 13 or Section 14.
9. The advice letter contained no information regarding the cycle in which gas was purchased, making it difficult to determine whether transactions fell within the Section 13 safe harbor.
10. The advice letter contained no information about the NGI Bidweek averages for the December-February season, which are needed to determine whether Section 18 purchases and sales meet the criteria for reasonableness.
11. The advice letter did not include the information about overnomination events required by Resolution G-3486.
12. SoCalGas should submit a supplemental Advice Letter numbered 4690-A that includes: a) a detailed explanation of why the five transactions not found reasonable under Section 13 or 14 should be found reasonable under Section 16, and b) the information required by Resolution G-3486.

**THEREFORE IT IS ORDERED THAT:**

1. The purchase and sales transactions detailed in Southern California Gas Company Advice Letter 4690 are approved, with the exception of five purchase transactions:
  - TC# 2157 for flow date 9/5/13;
  - TC# 2351 for flow date 11/27/13;
  - TC#2443 for flow date 2/4/14;
  - TC#2444 for flow date 2/4/14; and
  - TC#2551 for flow date 8/12/14.
2. In all future Annual Compliance Reports, for purchases to be evaluated as reasonable under Section 13 of Rule 41, SoCalGas shall include the cycle in which the transaction was executed.
3. In all future Annual Compliance Reports, SoCalGas shall include a table that includes the following monthly data for all transactions to be evaluated as reasonable under Section 18 of Rule 41:
  - a. NGI's Bidweek average for "Southern Cal. Bdr. Avg.";
  - b. NGI's Bidweek average for "Southern Cal. Bdr. Avg." + 8.2 cents/dth;
  - c. NGI's Bidweek average for "SoCal Citygate"; and
  - d. 90% of NGI's Bidweek average for "SoCal Citygate"
4. SoCalGas shall submit, within 30 days of this Resolution, a Tier 2 supplemental Advice Letter numbered 4690-A that provides information concerning:
  - a. the reasonableness of the five purchase transactions;
  - b. the frequency of events where overnominations occurred system-wide yet the System Operator was required to maintain minimum flows to the Southern System;
  - c. the effectiveness of the 10% margin of error and any need to increase or decrease the margin; and
  - d. the observed impact on other receipt points.

This Resolution is effective today.

I certify that the foregoing resolution was duly introduced, passed and adopted at a conference of the Public Utilities Commission of the State of California held on August 13, 2015; the following Commissioners voting favorably thereon:

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TIMOTHY J. SULLIVAN  
Executive Director